BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
BELLE V. BAPTISTA)

Appearances:

For Appellant: Ronald H. Pacheco
Certified Public Accountant

For Respondent: Mark McEvilly
Counsel

OPINION

This appeal is made pursuant so section 19057, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Belle V. Baptista for refund of personal income tax in the amount of $1,601.00 for the year 1976.

Appellant's, California personal income tax return for 1976 showed capital gain income of $37,557.00. That amount represented 50 percent of $75,115.00 reported long-term gain (ga-.n on a capital asset held for more than five years) realized on the sale of a 22-unit apartment house. Appellant's gain on that sale was the difference between the property's net sale price of $258,198.00 and its adjusted cost basis of $183,083.00 ($188,451.00 original cost plus $40,917.00 capital improvements, less an adjustment of $46,285.00 for depreciation claimed and allowed in prior years).

In late 1978 the Internal Revenue Service (IRS) adjusted appellant's federal tax liability for 1976 by adding a minimum tax on the capital gain preference income realized from the aforementioned sale.

On December 15, 1979, shortly after the IRS notified respondent of the adjustment, appellant filed an amended California return for 1976. The amended return reflected a $23,651.00 reduction in taxable income, $509.00 of which represented an increase in claimed medical expenses and $23,142.00 of which represented a reduction in reported capital gain income. 'In explanation of the latter modification, appellant stated that none of the previously claimed depreciation should have been used to reduce the basis of the apartment house as such depreciation had resulted in no tax benefit. Appellant requested a refund of $450.00, which was the amount of tax 'paid with her original 1576 return.

On May 1, '1979, respondent issued a proposed assessment of additional tax based 'on capital gain preference income of $37,577.00. The preference income amount was derived from appellant's originai 1976 return. On June 19, '1979, respondent issued a notice of action denying, appellant's claim for refund asserted on her amended. return. On August 20, 1979, appellant paid the additional tax assessed.

On September 11, 1979, appellant filed a second amended return for 1976. On this return appellant reported total depreciation of $13,125.00 on the apartment house. Using this figure, appellant. calculated the long term gain on the 'sale of that property to be $43,335.00. This resulted in reported capital gain income of $21,667.50, which was a reduction of $15,889.50 from the amount reported on appellant's original 1976 return. Appellant also claimed a $15.00 retirement income credit. On the basis of these changes, appellant requested a refund of $1,601.00.

Appellant's reason for the depreciation reduction noted on this second amended return was that the previously claimed and allowed depreciation had exceeded the amount allowable. Appellant stated that depreciation claimed in-excess of that allowable should not be used to reduce the basis of an asset sold, 'and therefore increase the taxable

gain, where no tax benefit or reduction in tax liability resulted from such excess depreciation. In substantiation of the claim that no tax benefit was received from the excess depreciation, appellant submitted partial returns for three (1972, 1974, and 1975) of the previous five years over which depreciation had been claimed. Appellant's contentions were considered, but on October 16, 1980, respondent issued a notice of action disallowing the claimed refund. This appeal followed.

The first issue for our consideration in whether appellant's refund claim made on her second amended return is barred in whole or in part by the prior refund claim made on appellant's first amended return.

Section 19057 of the Revenue and Taxation Code provides in pertinent part as follows:

> (a) ... (A)t the expiration of 90 days from the mailing of the notice, the Franchise Tax Board's action upon the claim is final unless within the 90-day period the taxpayer appeals in writing from the action of the Franchise Tax Board to the board.

Instead of appealing respondent's action on her first refund claim, appellant chose to file a second refund claim. Respondent argues that in that case section 19057 bars the second claim since the first one had become final and involved a substantially similar issue. We disagree. We believe that each of the two refund claims presents a different question of law.

The general or overall inquiry applicable as to both claims for refund is whether a downward adjustment in basis must be made on account of depreciation claimed and allowea. It is noteworthy that the answer to this question was unsettled until the United States Supreme Court decided in 1943 that the amount allowed as depreciation reduces basis even where such depreciation was excessive and conferred no tax benefit to theextent of 'the excessive portion. (Virginian Hotel Corp.' v. Helvering, 319 U.S. 523 [87 L.Ed 1561] (1943.) This decision led Congress to enact legislation specifically modifying the Supreme Court's interpretation. (See S. Rep. No. 1160, 82d Cong., 2d Sess. (1952) [1952 U.S. Code Cong. & Ad. News 21671.) For years beginning on or after January 1, 1952, the required downward adjustment to basis is in the amount of the greater of (a) the amount allowed as a aeauction for depreciation in computing the taxpayer's income to the extent that it reduced the taxpayer's income taxes, or (b) the amount allowable for the years involved. (Int. Rev. Code of 1954, § 1016(a)(2), formerly § 113(b)(1)(B) of the Int. Rev. Code of 1939, as amended; also see Rev. & Tax. Code, § 18052.) In this context, "allowable" depreciation is that which the taxpayer is legally entitled to deduct whereas "allowed"

depreciation is that which the taxpayer claimed without challenge. (Virginian Hotel Corp., supra.)

The question presented by appellant's first claim for refund is whether all the depreciation previously claimed and allowed should be disregarded in determining adjusted basis upon sale because none of such depreciation resulted in any tax benefit to the taxpayer. Put another way, appellant wanted to disregard all the previously "allowed" depreciation, no matter how much of such depreciation had been properly "allowable."

The second, claim for refund, on the other hand, acknowledged that basis must be reduced by all previously cla-imed depreciation that was properly "allowable," i.e., the amount of depreciation that appellant was legally entitled to deduct. However, appellant requested the disregard of "allowed" depreciation in excess of that "allowable" on the premise that such excessive depreciation had given appellant no tax benefit. The second refund claim thus conceded the error of the first refund claim but asked for the exclusion of a portion of the depreciation claimed in prior years. In our opinion, the claims so viewed treated different amounts of the total depreciation in question and presented different theories in support of the requested actions. Under these circumstances, we do not believe that the first refund claim barred the second refund claim here under review.

As can be gathered from the discussion above, the principal inquiries in this ap'peal are whether depreciation reported by appellant in prior years was erroneously in excess of what should have been allowable, and if so, whether such excessive depreciation failed to confer a tax benefit so that appellant was not required to utilize such excess to reduce the basis of the apartment house she sold.

Appellant's claim that the depreciation previously reported was more than was allowable is based on a revision, or in her words, a -correction, of the apartment house's useful life, salvage value, and allocation of purchase price to land. These changes, states appellant, caused the IRS to mddify its original adjustment on which respondent's current action is based. However, appellant has not presented this board. with any evidence that the federal action was later mociified. Rather, appellant has merely argued that facts in existence at the time appellant purchased the apartment house dictate the changes claimed and has provided schedules showing the lesser depreciation resulting from the use of the revised factors. Our evaluation of this presentation is that it provides little or no evidence that the facts in 1970 were such to support the retroactive changes appeliant now wants made. For example, absolutely nothing in the record before us is supportive of a change in the originally reported salvage value. Even the purported change in the allocation to land factor i's questionable in light of

county assessor infcr-mation greatly at variance with appellant's proposal. Lastly, the proposed increase in useful life, while said to bring that factor more in line with IRS guidelines appears arbitrary in the absence of an explanation why appellant originally chose another shorter useful life. In short, appellant's arguments for changing the salvage value, useful life, and allocation to land with respect to the apartment building are inadequate. We simply do not have sufficient evidence in the record before us to conclude that appellant has carried her burden of proof that the indicated factors should be changed.

Even if that were not so, another shortcoming in appellant's presentation exists as to the claim that the purported excess depreciation resulted in no tax benefit. Appellant's responsibility in this regard is to show her tax situation for the years affected botn before and after the depreciation change she proposes. No such showing has been made by virtue of the partial returns she has submitted, since returns for 1970, 1971 and 1973 are missing. We therefore must conclude that respondent's proposed assessment of additional tax based on the federal adjustment to appellant's income tax liabilities for 1976 must stand.1/

The final item for our consideration is appellant's claimed retirement income credit. We believe that appellant has failed to demonstrate entitlement to that credit. For the year under review, one of the requisites for the income tax credit at issue was that the taxpayer, or the taxpayer's deceased spouse, have earned income in excess of $600.00 for each of the ten years before the taxable year involved. (Former Rev. & Tax. Code, § 17053, subds. (a) and jb), repealed by Stats. 1977, "'Ch. 1079.) Earned income, in the context of that credit, included "wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, ..." (Former Rev. & Tax. Code, § 17053, subd. (g); also see former Int. Rev. Code of 1954, § 911(b).) The only income indicated in appellant's return for any of the years prior to 1976 is capital gain and interest income. Such income is not "earned income" for purposes of section 17053. Therefore, the requirements for the claimed retirement income credit have not been met, and respondent's disallowance thereof was proper.

1/ Respondent has also noted that appellant's second refund claim Tails to include a minimum tax on the $21,667.50 capital gain preference income resulting from her revised figures. In light of our holding that appellant has not proven that her capital gain preference income should have been less than that derivable from the federal adjustment referenced herein, that oversight is of no consequence.

Appeal of Belle V. Baptista

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Belle V. Baptista for refund of personal income tax in the amount of $1,601.00 for the year 1976, be and the same is hereby sustained.

Done at Sacramento, California this 7th day of December, 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Richard Nevins, Member

_____, Member

_____, Member

_____, Member